Q. Please provide current DBRS reports or papers that establish criteria or ranges of credit metrics for Canadian Crown-owned electric utilities to qualify for each credit rating level.

A. Please see PUB-Nalcor-253, Attachment 1 for the current DBRS report that establishes criteria or ranges of credit metrics for Canadian Crown-owned electric utilities to qualify for each credit rating level.

For Crown-owned utilities with debt guaranteed by their respective Province, the credit rating is ultimately a flow-through from that Province, so the metrics will not necessarily align with the attached criteria. For Crown-owned utilities that are not guaranteed by the Province the assessment of their metrics would be the same as any other utility.

Please also refer to PUB-Nalcor-253, Attachments 2 to 5, which include additional DBRS reports referenced in PUB-Nalcor-253, Attachment 1.

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METHODOLOGY

Rating Companies in the Regulated Electric, Natural Gas and Water Utilities Industry

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Table of Contents

Scope and Limitations

This methodology represents the current DBRS approach for ratings in the regulated electric, natural gas and water utilities industry. It describes the DBRS approach to credit analysis, which includes consideration of historical and expected business and financial risk factors as well as industry-specific issues, regional nuances and other subjective factors and intangible considerations. DBRS's approach incorporates a combination of both quantitative and qualitative factors. The methods described herein may not be applicable in all cases; the considerations outlined in DBRS methodologies are not exhaustive and the relative importance of any specific consideration can vary by issuer. In certain cases, a major strength can compensate for a weakness and, conversely, a single weakness can override major strengths of the issuer in other areas. DBRS may use, and appropriately weight, several methodologies when rating issuers that are involved in multiple business lines. Further, this methodology is meant to provide guidance regarding the DBRS methods used in the sector and should not be interpreted with formulaic inflexibility, but understood in the context of the dynamic environment in which it is intended to be applied.

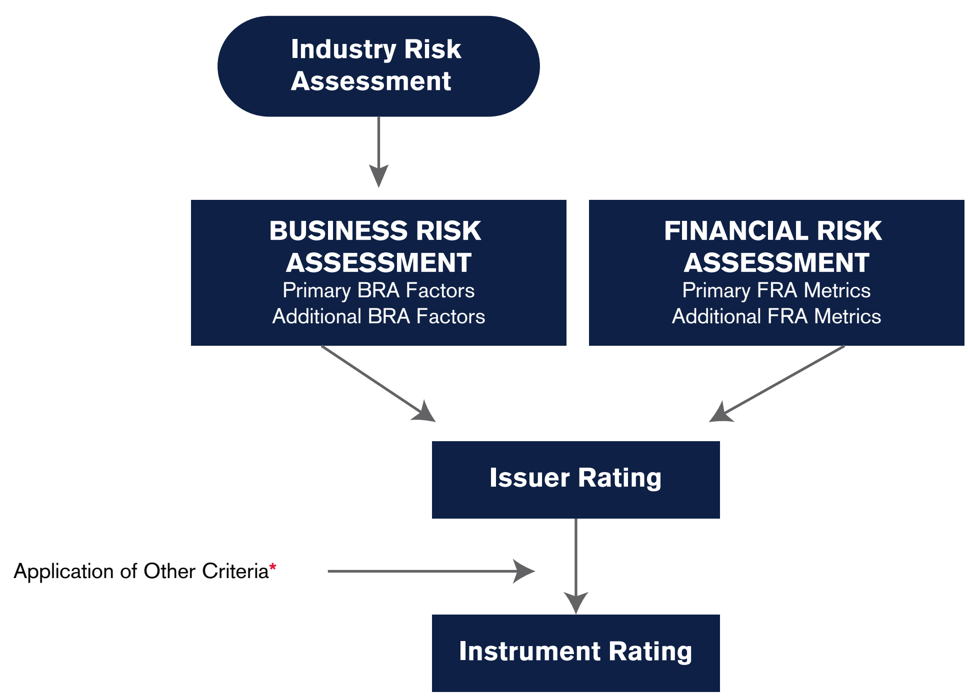
Introduction to DBRS Methodologies

- DBRS publishes rating methodologies to give issuers and investors insight into the rationale behind DBRS's rating opinions.
- In general terms, DBRS ratings are opinions that reflect the creditworthiness of an issuer, a security or an obligation. DBRS ratings assess an issuer's ability to make timely payments on outstanding obligations (whether principal, interest, preferred share dividends or distributions) with respect to the terms of an obligation. In some cases (e.g., non-investment grade corporate issuers), DBRS ratings may also address recovery prospects for a specific instrument given the assumption of an issuer default.
- DBRS operates with a stable rating philosophy; in other words, DBRS strives to factor the impact of a cyclical economic environment into its ratings wherever possible, which minimizes rating changes due to economic cycles. Rating revisions do occur, however, when more structural changes, either positive or negative, have occurred, or appear likely to occur in the near future.
- DBRS also publishes criteria which are an important part of the rating process. Criteria typically cover areas that apply to more than one industry. Both methodologies and criteria are publicly available on the DBRS website and many criteria are listed below under "Rating the Specific Instrument and Other Criteria."

Overview of the DBRS Rating Process

- There are generally three components to the DBRS corporate rating process: (1) an industry risk assessment (IRA); (2) an issuer rating; and (3) considerations for specific securities. The figure below outlines this process.
- An IRA is a relative ranking of most industries that have a DBRS methodology, typically using just three ranges of the DBRS long-term debt rating scale (i.e., "A," BBB and BB), without making use of the "high" or "low" descriptors. The IRA is a general indication of credit risk in an industry and considers, among other things, an industry's: (1) profitability and cash flow; (2) competitive landscape; (3) stability; (4) regulation; and (5) other factors. An "industry," for the purposes of the IRA, is defined as those firms that are generally the larger, more established firms within the countries where the majority of DBRS's rated issuers are based; this remains true for DBRS methodologies that are more global in nature. The IRA helps DBRS set the business risk assessment (BRA) grid (see below) in that it positions, in an approximate way, an average firm in the industry onto the BRA grid. For firms in industries with low IRAs, the IRA can, in effect, act as a constraint or "cap" on the issuer's rating.
- The issuer rating is DBRS's assessment of the probability of default of a specific issuer. It is a function of: (1) the BRA, determined by assessing each of the primary and (where relevant) additional BRA factors in the BRA grid for a specific issuer; and (2) the financial risk assessment (FRA), determined by assessing each of the primary and (where relevant) additional FRA metrics. The two components, BRA and FRA, are combined to determine the issuer rating; in most cases, the BRA will have greater weight than the FRA in determining the issuer rating. Throughout the BRA and FRA determination process, DBRS performs a consistency check of the issuer on these factors against the issuer's peers in the same industry.
- The issuer rating is then used as a basis for specific instrument ratings. DBRS assigns, for example, a recovery rating and notches up or down from the issuer rating to determine a specific instrument rating for instruments of non-investment grade corporate issuers. (See "Rating the Specific Instrument and Other Criteria," below.)

DBRS Rating Analysis Process



* Depending on the instrument, "other criteria" may include *DBRS Criteria: Recovery Ratings for Non-Investment Grade Corporate Issuers* or *DBRS Criteria: Preferred Share and Hybrid Security Criteria for Corporate Issuers*, for example. Please refer to the section below entitled "Rating the Specific Instrument and Other Criteria" for a list of these criteria, as well as other criteria that may be applicable at any stage of the rating process.

Regulated Electric, Natural Gas and Water Utilities Industry

- This methodology applies to rate-regulated utilities whose primary business includes one or more of the following areas: (1) regulated electric generation, transmission and distribution; (2) natural gas transmission and distribution; and (3) water and waste-water utilities.
- For companies that have both material regulated and non-regulated operations in other related industry segments (e.g., non-regulated electricity generation, energy marketing or trading), DBRS applies both this and the *Rating Companies in the Independent Power Producer Industry* methodology. For pipeline or diversified energy companies, see *Rating Companies in the Pipeline and Diversified Energy Industry*. For energy-related project finance transactions, see *Rating Project Finance, Rating Wind Power Projects or Rating Solar Power Projects.*
- Per the three-tier industry risk rating system described on the previous page, this industry's IRA is "A."
- For the electric-related utilities, there are three broad business areas: generation, transmission and distribution. Some utilities are fully integrated and participate in all three, while others may be involved in only one or two segments.
- Regulated utilities are typically monopolistic. Because of the large amount of fixed costs, one large utility firm can generally provide service at a lower cost than two or more firms serving the same customer base. Utilities are generally regulated by an administrative tribunal (i.e., a government agency) created by statute to assist ratepayers in obtaining reliable energy services on a cost-effective basis. Rate-setting mechanisms generally ensure that utilities receive adequate revenues to recover all costs prudently incurred, including cost of capital, to provide service.
- Utilities are typically regulated under either a traditional cost-of-service (COS) framework or some form of incentive regulation mechanism (IRM).
- The risks associated with environmental regulation are growing, particularly for the electric industry; however, for a regulated utility, future cost increases attributable to environmental regulation would be expected to be recovered from ratepayers.
- Long-term threats include competition from new distributed energy resources (such as solar and geothermal power) and small-scale power generation sources located close to end users that provide an alternative to traditional electric power generation as well as the transmission and distribution grid.
- Water and waste-water utilities typically operate under similar regulatory frameworks to other regulated distribution utility operations; however, water and waste-water sector regulations can vary widely given that regulation may be at the municipal level, rather than the national/state/provincial level. In addition, capital spending may be more volatile for water and waste-water utilities.

Regulated Electric, Natural Gas and Water Utilities BRA

Primary BRA Factors

The BRA grid below shows the primary factors used by DBRS in determining the BRA. While these primary factors are shown in general order of importance, depending on a specific issuer's business activities, this ranking can vary by issuer.

Regulated Electric, Natural Gas and Water Utilities – Primary BRA Factors

Regulation – The quality of the regulatory regime is typically the most important BRA factor, as it lays the foundation for utilities' earning capacity, cost recovery mechanisms and capital structure. A supportive regulatory framework contributes to stable cash flow and earnings, underpinned by a fair rate of return and a full and timely recovery of costs. To determine the BRA for regulation, DBRS reviews eight considerations (see Appendix 1) to assess the regulatory framework in which the utility conducts its business. The eight considerations include the following: (1) deemed equity ratio, (2) allowed return on equity (ROE), (3) energy cost recovery, (4) capital cost recovery (CCR) and operating cost recovery (OCR), (5) COS versus IRM, (6) political interference, (7) stranded cost recovery and (8) rate freeze.

AA	A	BBB	BB/B
• Highly supportive regulatory framework with the majority of relevant key regulatory risk factors in Appendix 1 considered to be "excellent."	• Supportive regulatory framework with the majority of relevant key regulatory risk factors in Appendix 1 considered to be "good" or better.	• Reasonable regulatory framework with the majority of relevant key regulatory risk factors in Appendix 1 considered to be "satisfactory" or better.	• Poor regulatory framework with the majority of relevant key regulatory risk factors in Appendix 1 considered to be "below average" and/or "poor."

Diversification (Products/Markets) – DBRS views the electricity transmission segment as having the lowest risk, as the transmission grid forms the backbone of the industry and generally represents the smallest portion of the average residential electricity bill. As a result, there is strong political will to support the transmission owner to maintain safe, reliable operation of the system. The electricity distribution and gas transmission/distribution segments generally entail modestly higher risk, as the distribution segment accounts for a greater portion of the average residential bill and the gas segment is exposed to integrity management risk. The generator segment has the highest risk, as it is exposed to fuel risk and higher operating risk than that of other segments; it also represents the highest portion of the electricity bill, which makes it more susceptible to political risk especially in a rising power cost environment. Diversification across low-risk multi-line businesses is positive, limiting the impact of changes in one particular segment.

AA	A	BBB	BB/B
• Primarily electric transmission. • Well-diversified utilities with a range of businesses throughout the utility value chain (natural gas transmission and distribution, electricity transmission and distribution).	• Electric or gas distribution, water or waste-water distribution/services, or an integrated utility or generator with a low-risk profile.	• Integrated utility or generator with a moderate-risk profile.	• Integrated utility or generator with a high-risk profile.

Franchise and Customer Mix – Operating in stable and economically strong service areas generally results in revenue stability and low accounts-receivable write-offs, as well as minimizing political interference risk in a rising electricity rate environment. DBRS considers both the economic strength of a utility's customer base and the size of the customer base when assessing whether customers will be able to absorb rate increases. Customers in an economically strong service territory are more able to absorb higher rate increases, while a larger customer base would allow capital and operating costs to be spread out over a greater number of customers. Utilities with a higher proportion of residential and commercial customers also possess the ability to better weather economic downturns and demonstrate more stable operating performances than utilities with a greater exposure to industrial customers, which are more inclined to seek lower-cost or more reliable suppliers and are prone to economic cyclicality. However, utilities with a large residential customer base are generally more sensitive to weather conditions, exposing the utilities to greater volume risk.

AA	A	BBB	BB/B
• Strong and consistent levels of load growth. • Economically vibrant service territory, with income that is significantly above the national average. • Utility has a significant customer base (i.e., large metropolitan area or province/state). • Customer mix predominantly residential and commercial.	• Reasonable load growth generally tracking the broader economy. • Economically strong service territory, with income above the national average. • Utility has a sizeable customer base. • Customer mix heavily weighted toward residential and commercial.	• Minimal load growth. • Economically stagnant service territory, with income that is in line with the national average. • Utility has a reasonably sized customer base. • Customer mix a balance of residential and commercial versus industrial.	• Consistent load declines. • Economically weak service territory, with income that is below the national average. • Utility has a shrinking customer base. • Customer mix weighted toward cyclical industrials.

Operating Efficiency (Inputs and Costs) – Utilities with a proven track record of superior operating efficiency generally sustain profitability above their respective regulatory return parameters (i.e., the "allowed" or "deemed" ROE as distinct from the "actual" ROE, which is the company's reported ROE as presented in regulatory filings) and record above-average profitability relative to their peers. Improving operating efficiency also helps minimize political interference (in the form of, for example, the creation of stranded costs, a rate freeze or regulatory lag in the recoupment of costs) in recovering rising input costs and refurbishment costs for aging infrastructure. DBRS notes that while a bigger utility (by asset or rate base) should possess a stronger ability to achieve economies of scale as well as raise funds and execute capital projects, they may, however, be under extra scrutiny by the regulator to meet higher thresholds.

AA	A	BBB	BB/B
• Actual ROE has significantly exceeded the allowed ROE as a result of continued operating efficiency. • Strong ROE outperformance is expected to be well-sustained in the foreseeable future through incremental cost savings accruing to the company. • Utility is of large comparative size, allowing for significant economies of scale.	• Actual ROE has been in line with the allowed ROE or a difference between the allowed ROE and the actual ROE has not been material. • ROE performance is expected to remain in line with the allowed ROE for the foreseeable future. There is no expectation of material incremental cost savings arising in the foreseeable future. • Utility is of sufficiently large size to achieve economies of scale.	• Actual ROE has been somewhat below the allowed ROE, and this negative ROE performance relative to allowed ROE is expected to continue for the foreseeable future with no expectation of any material incremental cost savings. • Utility is of reasonable size to achieve some economies of scale.	• The utility has generated much lower actual ROE than the allowed ROE, and this negative ROE performance relative to allowed ROE is expected to continue for the foreseeable future with no expectation of any material incremental cost savings. • Small utility that can only achieve modest, if any, economies of scale.

The following BRA risk factors are relevant to issuers in all industries (although the relevance of sovereign risk can vary considerably):

Sovereign Risk – The issuer rating may, in some cases, be constrained by the credit risk of the sovereign; in other words, the rating of the country in which the issuer operates generally sets a maximum rating for the issuer. If the issuer operates in multiple countries and a material amount of its business is conducted in a lower-rated country, DBRS may reflect this risk by downwardly adjusting its issuer rating.

Corporate Governance – Please refer to *DBRS Criteria: Evaluating Corporate Governance* for further information on how DBRS evaluates corporate governance and management.

Additional BRA Factors

- The additional BRA factors discussed below may be very important for certain issuers, depending on their activities, but they do not necessarily apply to all issuers in the industry.

Capital Spending

- Utilities are capital-intensive businesses. A utility might undertake large capital projects to either meet growing demand in a high-growth franchise area or replace significant aging assets. This could potentially lead to cost overruns and weaker financial metrics – at least during the growth phase.
- For utilities undergoing very significant multi-year capital expansion programs, capital spending may be considered a primary rating factor. This would be particularly relevant for companies with significant nuclear generation development.

Supply/Demand Considerations

The provision of utility services depends on the presence of adequate supplies of energy (e.g., natural gas and electricity) to meet end-user demand. For electric utilities, generation of sufficient electricity to meet demand is paramount.

Ownership

- The existence of a highly rated parent typically does not result in a lift to a stand-alone utility's rating; however, DBRS may impute some level of support in a utilities rating if it is owned by a highly rated city, despite no explicit guarantee being in place, given the potential unique circumstances of the city-utility relationship.

Retail Exposure

- Distribution companies may be required to provide retail services to customers, such as electricity supply. Under this framework, utilities, depending on commercial arrangements, could be exposed to significant market risk. Key areas of analysis therefore include hedging policies, counterparty risk and the size of the operation. Rates are, however, generally passed on to ratepayers, thereby reducing the risk to the utility.

Competitive Environment

- DBRS assesses the degree of competition from other forms of energy or any other potential threats to natural monopoly, including material development of new distributed energy resources and small-scale power generation sources located close to end users that could ultimately provide an alternative to the traditional electric power transmission and distribution grid.

Environmental Issues

- DBRS assesses the extent to which utilities face environmental laws and regulations that can have an impact on a company's business and prospects, including issues related to safety (i.e., operating nuclear facilities and handling radioactive material). DBRS also includes in its analysis the impact recurrent natural weather hazards (such as hurricanes or flood risk) have on a utility's service territory.

Regulated Electric, Natural Gas and Water Utilities FRA

Primary FRA Metrics

- The FRA grid below shows the primary FRA metrics used by DBRS to determine the FRA. While these primary FRA metrics are shown in general order of importance, depending on an issuer's activities, the ranking can vary by issuer.
- DBRS ratings are based heavily on future performance expectations, so while past metrics are important, any final rating will incorporate DBRS's opinion on future metrics, a subjective but critical consideration.
- It is not unusual for a company's metrics to move in and out of the ranges noted in the grid below, particularly for cyclical industries. In the application of this matrix, DBRS looks beyond the point-in-time ratio.
- Financial metrics depend on accounting data whose governing principles vary by jurisdiction. DBRS may adjust financial statements to permit comparisons with issuers using different accounting principles (e.g., U.S. Generally Accepted Accounting Principles versus International Financial Reporting Standards (IFRS)).
- The appendix to this methodology provides definitions for the FRA metrics cited in the table below. Please refer to *DBRS Criteria: Common Adjustments for Calculating Financial Ratios* for a discussion of common adjustments used in the calculation of these FRA metrics.
- DBRS considers an issuer's financial policy, including factors such as its targeted financial leverage, its dividend policy and the likelihood of share buybacks or other management actions that may favour equityholders over bondholders.
- Liquidity can be an important credit risk factor, especially for lower-rated non-investment grade issuers. While ratios such as the current or quick ratio can give an indication of certain short-term assets in comparison with short-term liabilities, DBRS will typically review all material sources of liquidity (including, for example, cash on hand, cash flow from operations, availability of bank funding, etc.) in comparison with all material short- and medium-term uses of liquidity (such as operations, capital expenditures (capex), mandatory debt repayments, share buybacks and dividends, etc.).
- While free cash flow (i.e., net of changes in working capital, dividends and capex, etc.) can be volatile and, on occasion, negative, DBRS may use this and/or other cash flow metrics, such as cash flow from operations, to assess a company's ability to generate cash to repay debt.
- While market pricing information (such as market capitalization or credit spreads) may on occasion be of interest to DBRS, particularly where it suggests that an issuer may have difficulty in raising capital, this information does not usually play a material role in DBRS's more fundamental approach to assessing credit risk.

The following table represents financial metrics related to fully regulated utilities with only modest exposure to non-regulated operations. Significant exposure to non-regulated operations would result in increasingly stringent financial metrics criteria at the various rating levels.

Regulated Electric, Natural Gas and Water Utilities – Primary FRA Metrics

Primary Metric	AA	A	BBB	BB/B
Cash flow-to-debt	> 17.5%	12.5% to 17.5%	10.0% to 12.5%	0.0% to 10.0%
Debt-to-capital	< 55%	55% to 65%	65% to 75%	75% to 90%
EBIT-to-interest	> 2.8x	1.8x to 2.8x	1.5x to 1.8x	1.0x to 1.5x

Additional FRA Metrics

- While the primary FRA metrics above are the most important metrics that DBRS uses in determining the FRA of an issuer, other metrics may be used, depending on an issuer's activities, capital structure, pension liabilities and off-balance sheet obligations.
- DBRS notes that utilities rated below investment grade are typically rated as such because of heightened business risk levels, rather than for credit metric reasons.

Blending the BRA and FRA into an Issuer Rating

- The final issuer rating is a blend of the BRA and FRA. In most cases, the BRA will have greater weight than the FRA in determining the issuer rating.
- At the low end of the rating scale, however, particularly in the B range and below, the FRA and liquidity factors play a much larger role and the BRA would, therefore, typically receive a lower weighting than it would at higher rating levels.
- For regulated utilities, the quality of the regulatory regime, which is a BRA factor, often drives the FRA of a company since the deemed capital structure and ROE are often set by the regulator.

Rating the Specific Instrument and Other Criteria

- For non-investment grade corporate issuers, DBRS assigns a recovery rating and reflects the seniority and the expected recovery of a specific instrument, under an assumed event of default scenario, by notching up or down from the issuer rating in accordance with the principles outlined in *DBRS Criteria: Recovery Ratings for Non-Investment Grade Corporate Issuers*.
- Preferred share and hybrid considerations are discussed in *DBRS Criteria: Preferred Share and Hybrid Security Criteria for Corporate Issuers*.
- The issuer rating (which is an indicator of the probability of default of an issuer's debt) is the basis for rating specific instruments of an issuer, where applicable. DBRS uses a hierarchy in rating long-term debt that affects issuers that have classes of debt that do not rank equally. In most cases, lower-ranking classes would receive a lower DBRS rating. For more detail on this subject, please refer to the general rating information contained in the DBRS rating policy *Credit Ratings Global Policy*.
- For a discussion on the relationship between short- and long-term ratings, and more detail on liquidity factors, please refer to the DBRS policy *Short-Term and Long-Term Rating Relationships* and *DBRS Criteria: Commercial Paper Liquidity Support for Non-Bank Issuers*.
- The existence of holding companies can have a meaningful impact on individual security ratings. For more detail on this subject, please refer to *DBRS Criteria: Rating Holding Companies and Their Subsidiaries*.
- Guarantees and other types of support are discussed in *DBRS Criteria: Guarantees and Other Forms of Support*.
- For further information on how DBRS evaluates corporate governance, please refer to *DBRS Criteria: Evaluating Corporate Governance*.
- Please refer to *DBRS Criteria: Common Adjustments for Calculating Financial Ratios* for a discussion of common financial ratio adjustments.

Appendix 1: Regulation

- To determine the BRA for regulation (see page 6), DBRS reviews the eight considerations found below, which assess the regulatory framework in which the utility conducts its business.
- The ranking of the factors is based on a five-point scale (excellent, good, satisfactory, below average and poor).
- The first four factors are generally of greater importance than the others when assessing regulatory risk.
- While Considerations 1 to 5 can differ between utilities operating in the same jurisdiction, DBRS typically views Considerations 6, 7 and 8 as the same for all utilities within the same jurisdiction.

Consideration 1: Deemed Equity Ratio

Definition

The deemed equity ratio is the percentage of equity investment in the rate base on which a utility could earn a return. In general, the higher the deemed equity ratio, the higher the earnings for a utility.

Score	Item	Definition
Excellent	50.00%+	• The deemed equity ratio represents 50.00% or more of the utility's rate base. • The treatment of the deemed equity ratio is consistent historically.
Good	45.00% to 49.99%	• The deemed equity ratio represents 45.00% to 49.99% of the utility's capital structure. • The treatment of the deemed equity ratio is consistent historically.
Satisfactory	40.00% to 44.99%	• The deemed equity ratio represents 40.00% to 44.99% of the utility's capital structure. • The treatment of the deemed equity ratio has not been consistent historically.
Below Average	35.00% to 39.99%	• The deemed equity ratio represents 35.00% to 39.99% of the utility's capital structure. • The treatment of the deemed equity ratio has not been consistent historically.
Poor	Below 34.99%	• The deemed equity ratio represents less than 34.99% of the utility's capital structure. • The treatment of the deemed equity ratio has not been consistent historically.

Consideration 2: Allowed ROE

Definition

Allowed ROE is a measurement of returns on the deemed equity portion of the rate base. The regulator assesses and sets an allowed ROE based on a utility's business risk level. These allowed ROE levels assume a current North American or Western European inflationary environment.

Score	Item	Definition
Excellent	10%+	• An allowed ROE is set at 10.00% or higher. • The regulatory treatment of allowed ROE has been consistent historically.
Good	9.00% to 10.00%	• An allowed ROE is set at 9.00% to 10.00%. • The regulatory treatment of allowed ROE has been consistent historically.
Satisfactory	8.00% to 8.99%	• An allowed ROE is set at 8.00% to 8.99%. • The regulatory treatment of allowed ROE has been consistent historically.
Below Average	7.00% to 7.99%	• An allowed ROE is set at 7.00% to 7.99%. • The regulatory treatment of allowed ROE has not been consistent historically.
Poor	Below 7.00%	• An allowed ROE is set at below 7.00%. • The regulatory treatment of allowed ROE has not been consistent historically.

Consideration 3: Energy Cost Recovery

Definition

Fuel and purchased energy cost (F&PE) recovery certainty and the timing of recovery are critical in DBRS's assessment of a regulatory system within a certain jurisdiction. DBRS looks at the following factors: (1) whether F&PE costs are fully passed through to the customers, (2) how often a utility is allowed to adjust the F&PE costs in retail rates charged to customers and (3) if there is a mechanism within a jurisdiction to allow utilities to make F&PE cost adjustments with no or minimal regulatory review. In addition, DBRS also focuses on the generation mix within a certain market. A high power cost market could have an impact on the utility's ability to recover the purchased power costs in a timely manner. DBRS notes that this factor is not applicable for water and waste-water utilities.

Score	Item	Definition
Excellent	Monthly/bimonthly	• F&PE costs are fully passed through. • Adjustment is made on a monthly basis. • There is an automatic adjustment mechanism. • The jurisdiction is in a favourable generation mix market, resulting in low power cost.
Good	Quarterly	• F&PE costs are fully passed through. • Adjustment is made on a quarterly basis. • There is an automatic adjustment mechanism. • The jurisdiction is in a favourable generation mix market, resulting in low power cost.
Satisfactory	Quarterly with regulatory review	• F&PE costs are fully passed through. • Adjustment is made on a quarterly basis. • F&PE cost deferrals are subject to some regulatory review. • The jurisdiction is in a good generation mix market.
Below Average	Annually with automatic adjustment	• F&PE costs are fully passed through or utilities have minimal exposure to energy price volatility. • Adjustment is made on an annual basis and is subject to minimal or some regulatory review. • The jurisdiction is in a relatively high power cost market.
Poor	Annually with no automatic adjustment mechanism	• F&PE costs are fully passed through or utilities have minimal exposure to energy price volatility. • Adjustment is made on an annual basis. • F&PE cost deferrals are subject to regulatory review. • The jurisdiction is in a relatively high power cost market.

Consideration 4: Capital and Operating Cost Recoveries

Definition

In assessing CCR and OCR, DBRS focuses on the likelihood of a utility's capex being added to its rate base, along with the timing of such an addition. In addition, DBRS focuses on cost-inflation adjustments that could affect the timing of the OCR. In particular, DBRS looks at the following factors: (1) the utilization of future test periods for rate decisions, (2) whether the spending is allowed to be added to the rate base during the construction or will only be added when the project is completed, (3) the level of upfront capital spending required without regulatory approval, (4) the degree of regulatory lag and uncertainty with respect to the CCR, (5) whether or not there is a reasonable mechanism to deal with cost overruns and (6) the degree of volume risk for the recovery of both capital and operating costs.

Score	Item	Definition
Excellent	Minimal CCR and OCR lag risk	• Work-in-progress costs can be added to the rate base if capex is significant. • Interim base-rate increases have been frequently authorized. • Future test periods are fully incorporated for rate-case decisions. • Rate cases are typically decided well within one year unless the rate cases are litigated or unusual circumstances occur. • There is a reasonable mechanism to deal with cost overruns. • No volume risk.
Good	Reasonable CCR and OCR lag risk	• Capital costs are added to the rate base after completion of work. • Interim base-rate increases have been authorized from time to time. • Future test periods are at least partially incorporated for rate-case decisions. • Rate cases are typically decided within one year unless the rate cases are litigated or unusual circumstances occur. • There is a reasonable mechanism to deal with cost overruns. • Some volume risk exists, but is mitigated by either a high portion of rates being fixed or the use of deferral accounts.
Satisfactory	Modestly elevated CCR and OCR lag risk	• Capex is generally pre-approved by the regulator, but there is some modest upfront capital spending before regulatory approval. • Interim base-rate increases have been rarely authorized. • Historical test periods are commonly incorporated for rate-case decisions. • Rate cases are typically decided within one year unless the rate cases are litigated or unusual circumstances occur. • There is a reasonable mechanism to deal with cost overruns. • Some volume risk exists, but is mitigated by historically stable throughputs.

Below Average	Below-average CCR and OCR lag risk	• There is significant upfront capital spending before regulatory approval. • Interim base-rate increases have been rarely authorized. • Historical test periods are commonly incorporated for rate-case decisions. • Rate-case decisions typically take more than one year because of frequent court cases and other circumstances. • There are some mechanisms to deal with cost overruns. • Some volume risk exists due to a high portion of rates being variable.
Poor	Significant CCR and OCR lag risk	• Capex is generally not pre-approved by the regulator. • Capital costs are added to the rate base after completion of work. • Utilities face significant regulatory lag risk with respect to the CCR and the OCR. • There is no meaningful mechanism to deal with cost overruns. • Rates are fully variable with no fixed components.

Consideration 5: COS versus IRM

Definition

In general, under COS, regulated utilities are allowed to recover prudently incurred operating costs and earn a reasonable return on their investment. Under IRM, revenue requirements for the year are based on a COS base year, adjusted for inflation (using the consumer price index (CPI)) and subtracted a productivity factor, which is set by the regulator. This forces utilities to maintain their operational efficiency to achieve allowed ROE. DBRS views COS as lower risk than IRM. In addition, DBRS also considers the length of an IRM period between COS years. DBRS's scoring system gives a higher score for a shorter IRM period.

Score	Item	Definition
Excellent	COS	• The COS regime allows utilities to recover prudently and reasonably incurred operating costs.
Good	IRM (three years or shorter)	• The IRM regime is a maximum of three years between COS years. • For an IRM period of more than three years, there are reasonable mechanisms in place to mitigate unexpected capital investment and operating costs (i.e., downside protection). In addition, key IRM assumptions, including CPI and productivity factors, are reasonable.
Satisfactory	IRM (four- to five-year framework)	• The IRM period is four to five years.
Below Average	IRM (six- to ten-year framework)	• The IRM period is six to ten years.
Poor	IRM (ten-plus years)	• The IRM period is over ten years.

Consideration 6: Political Interference

Definition

Political interference refers to political risk that could occur within a jurisdiction. Political interference could be in the following forms: (1) influence on the regulator's ability to independently and impartially arrive at a decision, (2) passing legislation to override a decision made by the regulator and (3) the regulator being elected instead of being appointed.

Score	Definition
Excellent	• There is no government influence on the regulatory decision-making process. • There has been no adverse legislation in the regulated utility sector. • The regulator is appointed.
Good	• There is a low degree of government influence on the regulatory decision-making process. • There has been no adverse legislation in the regulated utility sector. • The regulator is appointed.
Satisfactory	• There is a low degree of government influence on the regulatory decision-making process. • There has been no adverse legislation in the regulated utility sector. • The regulator is appointed or elected.
Below Average	• There is a modest degree of government influence on the regulatory decision-making process. • There has been no adverse legislation in the regulated utility sector. • The regulator is appointed or elected.
Poor	• There is a high degree of government influence on the regulatory decision-making process. • There has been some adverse legislation in the regulated utility sector. • The regulator is appointed or elected.

Consideration 7: Stranded Cost Recovery

Definition

Stranded costs occur when a utility has already incurred costs (F&PE, operating cost or capital spending) and faces uncertainty as to when it can recover these costs. In some cases, stranded costs are written off if it is certain that these costs cannot be recovered. DBRS looks at the following factors: (1) whether stranded costs exist and their magnitude, (2) the likelihood of recovering stranded costs, (3) the frequency and materiality of writedowns and (4) the time it takes to recover these costs.

Score	Item	Definition
Excellent	No stranded cost	• No stranded costs associated with legitimate or reasonable costs incurred by utilities.
Good	Full recovery	• Some stranded costs exist. • Stranded costs are fully recovered in a timely manner. • No historical stranded cost writedowns.
Satisfactory	Occasional writedowns	• Some stranded costs exist. • Stranded costs are recovered but subject to some regulatory lag. • Occasional writedowns.
Below Average	Frequent writedowns	• Some stranded costs exist. • Stranded costs are sometimes recovered. • Frequent writedowns. • Takes considerable time to recover costs.
Poor	Frequent significant writedowns	• Significant stranded costs exist. • Stranded costs are not fully recovered. • Significant writedowns occur. • Significant regulatory lag associated with the recovery.

Consideration 8: Rate Freeze

Definition

A rate freeze refers to a fixed retail rate that is charged to customers during a period of time (more than two years) set by a regulator. DBRS does not typically penalize a utility for rate freezes that are part of an acquisition settlement agreement, as they are temporary in nature and only for a set period. During the rate-freeze period, utilities are exposed to increases in operating and energy costs. The longer the rate-freeze period or the more frequency with which a rate freeze occurs within a jurisdiction, the riskier it is for the utility.

Score	Item	Definition
Excellent	Never	• Rates are never frozen.
Good	Potential	• Rates have the potential to be frozen.
Satisfactory	Occasional	• Rates are occasionally frozen. • The frozen period is fewer than three years.
Below Average	Frequently	• Rates are frequently frozen. • The frozen period is fewer than three years.
Poor	Rate freeze	• Rates are currently frozen. • The frozen period is three years and longer.

Appendix 2: FRA Ratio Definitions and Common Adjustments for the Regulated Electric, Natural Gas and Water Utilities Industry

The primary FRA metrics cited in the table above are defined below, with a discussion of common adjustments that are made for the regulated electric, natural gas and water utilities industry. For related definitions and a broader discussion of the common adjustments made to the accounting data to permit ratio comparability between issuers, please refer to *DBRS Criteria: Common Adjustments for Calculating Financial Ratios.*

CASH FLOW-TO-DEBT = CASH FLOW FROM OPERATIONS / TOTAL DEBT

Cash flow from operations = core net income + depreciation + amortization + deferred taxes + other non-cash items from income statement (before changes in non-cash working capital items).

Total debt = short-term debt + long-term debt + hybrid debt portion + capital leases.

DEBT-TO-CAPITAL = TOTAL DEBT / TOTAL CAPITAL

Total capital = total debt + total preferred equity + total common equity + minority interest + capital leases.

EBIT-TO-INTEREST = EBIT / GROSS INTEREST EXPENSE

EBIT = revenue – cost of goods sold – selling, general and administrative expenses – depreciation – amortization.

Gross interest expense = all interest expense + debt hybrid interest expenses + capitalized interest.

DBRS may adjust certain inputs used in the calculation of the primary FRAs in order to better assess such metrics relative to an issuer's peers. In the regulated electric, natural gas and water utilities industry, DBRS typically adjusts debt and interest expense amounts for operating leases, notwithstanding that these amounts are generally not material. Additionally, in rare cases, DBRS also considers net debt amounts in the case of large companies with a long history of maintaining significant cash or equivalents on the balance sheet.

Press Release

DBRS Archives Rating Canadian Provincial Agents of the Crown Methodology

Provinces and Municipalities

April 30, 2019

DBRS archived its methodology "Rating Canadian Provincial Agents of the Crown," which was last published on April 17, 2018. This methodology has been superseded by DBRS's "Global Methodology for Government Related Entities" (the GRE methodology), following its finalization as noted in the press release published April 30, 2019, entitled "DBRS Publishes Final Methodology on Government Related Entities."

As a result of the archiving of the "Rating Canadian Provincial Agents of the Crown" methodology, the five issuers listed below will use the GRE methodology going forward:

-- Alberta Capital Finance Authority (rated AA with a Negative trend by DBRS)
-- British Columbia Hydro and Power Authority (rated AA (high) with a Stable trend by DBRS)
-- Ontario Electricity Financial Corporation (rated AA (low) with a Stable trend by DBRS)
-- The Manitoba Hydro-Electric Board (rated A (high) with a Stable trend by DBRS)
-- Saskatchewan Power Corporation (rated AA with a Stable trend by DBRS)

No ratings are expected to change as a result of the change in the methodology of these issuers to the GRE methodology.

Notes:
DBRS methodologies are publicly available on its website www.dbrs.com under Methodologies & Criteria.

For more information on this methodology, the above-referenced credits or on this industry, visit www.dbrs.com or contact us at info@dbrs.com.

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JANUARY 2019

METHODOLOGY

DBRS Criteria: Guarantees and Other Forms of Support

PREVIOUS RELEASE: JANUARY 2018

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Table of Contents

Scope and Limitations

This criteria outlines the current DBRS approach for determining the impact of guarantees and other forms of support on the rating(s) of an issuer and/or its securities for corporates.[1] This criteria also outlines DBRS's approach to guarantees provided by a government in respect of a government related entity's debt obligation (see Appendix). The methods described herein may not be applicable in all cases; the considerations outlined in DBRS methodologies are not exhaustive and the relative importance of any specific consideration can vary by issuer. This criteria is meant to provide general guidance regarding the DBRS methods and should not be interpreted with formulaic inflexibility, but understood in the context of the dynamic environment in which it is intended to be applied.

Overview

A company, often a parent company (the Supporting Entity) may give explicit (i.e., documented) financial support in the form of a guarantee (or other such document) to a weaker subsidiary or affiliated company (the Supported Entity or Issuer), such that DBRS may determine, if such support is structured properly, that it is appropriate to flow through the rating of the Supporting Entity to the Supported Entity without having to consider the stand alone credit quality of the Supported Entity. In the absence of explicit support, or even if there are weaker forms of explicit support present (such as a keepwell agreement or comfort letter), there may also be business, reputational and financial factors that DBRS believes may motivate a parent or affiliated company to provide meaningful support in its discretion (assessed ex ante as implicit support) to a Supported Entity. DBRS will assess each explicit- or implicit-support situation on a case-by-case basis. While the rating effect of a properly constituted guarantee generally results in a flow-through of the Guarantor's rating, the rating effect of weaker forms of explicit or implicit support can range from no rating uplift to the complete flow-through of the Supporting Entity's rating to the Supported Entity, depending on relevant factors (as discussed below under Primary Considerations in the Implicit Support section).

Explicit Support

There are generally three types of explicit support recognized by DBRS: (1) guarantees, (2) keepwell agreements (also referred to as credit support agreements) and (3) comfort letters. If the explicit support provided is with respect to performance or obligations, other than those that are generally rated by DBRS (i.e., other than principal and interest payment obligations), the criteria set out below may not apply. Furthermore, since legal systems and laws vary by jurisdiction, this criteria may be modified for local laws and precedents, particularly with respect to guarantees.

Guarantees

A financial guarantee is a contract under which a guarantor (the Guarantor) agrees to become responsible for the principal and interest payment obligations of a different debtor (the Guaranteed Entity) to a third-party creditor. Between guarantees, keepwell agreements and comfort letters, guarantees generally provide the strongest support as they create a legally enforceable obligation on the part of the Guarantor to service the Guaranteed Entity's debt. This legally enforceable obligation of the Guarantor may allow DBRS to rate the Guaranteed Entity at the same level as the Guarantor (often established as the senior unsecured debt rating of the latter). When rating specific securities benefiting from a guarantee, DBRS will consider if the guarantee relates to all present and future debt obligations of the Guaranteed Entity or if it applies only to certain specific securities.

DBRS recognizes that each financial guarantee is unique and may be drafted to address specific circumstances, including the legal framework of the jurisdiction of the guarantee itself and/or the Guarantor (i.e., civil code jurisdiction versus common law jurisdiction). The characteristics set out below are based on common law systems and, while DBRS generally expects guarantees to display the following characteristics, each guarantee is reviewed on a case-by-case basis.

1. This criteria may be used in a financial institution or sovereign context as well.

- The guarantee is an absolute, direct, irrevocable, unconditional and continuing obligation of the Guarantor and will survive the bankruptcy or insolvency of the Guaranteed Entity.
- The guarantee will not terminate until there is a full and final payment of the principal and interest due.
- The Guarantor waives all defences that would otherwise be available to Guarantors and waives the enforceability or pursuit of the underlying obligation against the Guaranteed Entity first before enforcement against the Guarantor.
- The Guarantor waives all rights of subrogation, reimbursement, contribution, set-off or participation against the Guaranteed Entity until the guaranteed obligations are paid in full.
- The guarantee is in favour of and enforceable by the third-party creditor relying on the guarantee.
- The guarantee is binding on successors and assigns of the Guarantor.
- The guarantee may not be amended or modified without the written consent of the third-party creditor relying on the guarantee.
- Upon default of the underlying obligation by the Guaranteed Entity and expiry of the applicable cure periods, the guarantee provides for the due and punctual payment of guaranteed obligations on demand.

DBRS may, in certain cases, require customary legal opinions from counsel for the Guarantor to confirm that the guarantee is a legal and binding obligation enforceable in accordance with its terms. Furthermore, if, for example, the Guarantor is in a jurisdiction other than the jurisdiction of the guarantee, or if DBRS has any other need for additional confirmation on the enforceability of the guarantee, DBRS may also require a legal opinion of whether a judgment obtained under the guarantee is enforceable against the Guarantor in the Guarantor's jurisdiction. Furthermore, to the extent the terms of the guarantee or the Guarantor are subject to a civil law jurisdiction, DBRS may also require a legal opinion supporting the enforceability of the guarantee against the Guarantor in the relevant jurisdiction.

Keepwell Agreements

Keepwell agreements may exist between a parent company and subsidiary, in which the parent company agrees to maintain a given level of equity in the subsidiary or ensure that certain financial ratios are maintained by the subsidiary. Unlike a guarantee, a keepwell agreement does not create a legally enforceable obligation on the part of a parent company to honour a subsidiary's debts. In the case of explicit support provided by weaker instruments, such as a keepwell agreement or a comfort letter, DBRS may also consider the possibility of implicit support from a Supporting Entity considering the business and reputational factors (as discussed below in the Implicit Support section).

Comfort Letters

A comfort letter is not a contractual agreement; rather, it is a letter that may be provided to creditors of a subsidiary borrower by the subsidiary's parent company that typically addresses the parent company's current policies and intentions with respect to the subsidiary.

A comfort letter on its own is viewed as a weak form of support, and jurisprudence suggests they are unenforceable and provide no legal basis for a claim against a parent company to recover defaulted obligations of a subsidiary. Nonetheless, as is the case with a keepwell agreement, DBRS may also consider the possibility of implicit support from a Supporting Entity considering the business and reputational factors (as discussed below in the Implicit Support section).

Implicit Support

When the assessment is strong (typically, but not exclusively, across all or most Primary Considerations; see next section), the starting point for the Issuer's rating will generally be the rating of the Supporting Entity, with the final rating for the Issuer typically ranging from parity to two notches below. DBRS notes that the bar for this approach is high, and such occurrences are rare.

Alternatively, if DBRS concludes that the evidence of support is less than strong and/or there are meaningful deficiencies present, the starting point for the rating of the Issuer will typically be the stand-alone strength of the Issuer, notched upward as appropriate for the more modest benefits from the relationship with the Supporting Entity. The larger the gap between the ratings of the Supporting Entity and the Supported Issuer (all else being equal), the larger the potential number of notches of ratings elevation may be.

The strength of implicit support and the extent of any rating uplift provided to an Issuer will generally be determined by DBRS, based on an assessment of Primary Considerations (see next section below) and the following general principles.

1. DBRS generally expects to see 100% ownership and control to give any ratings credit from implicit support. There can still be meaningful support with lower levels of ownership, but DBRS will typically conclude that implicit support is unlikely when the parent company does not have at least a controlling stake in the Issuer.
2. DBRS normally only infers implicit support from entities within the same corporate family, or in some situations, when there is shared ownership, such as with joint ventures. While it is possible that a sovereign entity, for example, may step in to support an unrelated industrial company (as opposed to a financial institution whose presence is critical to the financial system integrity), DBRS is extremely unlikely to infer potential support for such an industrial company from a sovereign entity[2] unless prior very strong public statements or other such evidence of potential support are available.
3. For implicit support to be factored into a rating, DBRS must be confident that support will be timely, even in periods of financial stress for the Supporting Entity, and that support will be in place for the foreseeable future (which, at a minimum, would provide DBRS with comfort through the term of the rated debt).
4. While potentially beneficial to the Issuer, implicit support (when viewed by DBRS as considerable) may be treated as a contingent liability for the Supporting Entity and adversely affect its credit profile, particularly if the Issuer is large, significantly riskier or highly leveraged.
5. The Supporting Entity's ownership of an Issuer may lead it to protect its investment. This generally happens only when the Supporting Entity perceives that it will obtain greater long-term benefits from providing support to the Issuer relative to the cost of providing that support.

Primary Considerations for Implicit Support

The Primary Considerations used by DBRS to assess whether an Issuer can benefit from implicit support are listed below. Not all factors need to be present for some degree of implicit support, but strong support is more likely to be assessed when multiple factors are involved.

1. *Essentiality:* The relationship between the Issuer and the Supporting Entity, particularly in how essential the Issuer is to the Supporting Entity's business, is a strong consideration when assessing whether an Issuer would be supported by its Supporting Entity. Examples include when the Issuer is a critical/integral component of the Supporting Entity's production, sales or operations that would cause major issues/disruptions for the Supporting Entity if Issuer was removed.
2. *Contractual Obligations:* The existence of long-term contracts tying two parties together, such as leases or critical supply contracts, can provide the Supporting Entity with a high incentive to support the Issuer. Cross-default and cross-acceleration provisions between the two entities can also be a consideration, but only to the extent that the Supporting Entity's debt, carrying such provisions, is material and expected to be outstanding for a term that is longer than that of the Issuer's debt.

2. Refer to *DBRS Criteria: The Link between Sovereign Ratings and Government Related Entities* on how DBRS determines the ratings of government-related entities (GREs).

3. *Reputation:* When letting the Issuer fail entails considerable reputational risk for the Supporting Entity. In this case, letting the Issuer fail could lead to negative repercussions for the Supporting Entity or other related issuers, such as being shut out of the debt market or facing sharply higher spreads at refinancing. Sharing a common name (or brand) and past public comments about the support can also be regarded as reputational considerations. Ownership in and of itself is not necessarily viewed as a significant driver of implicit support, generally leading, at best, to modest rating uplift. However, ownership can create strong uplift when it is a complement to reputational factors or other Primary Considerations.
4. *Integration:* The degree of integration between the Supporting Entity and the Issuer may be an important consideration. This involves assessing the extent of operational and strategic ties within the parent-subsidiary relationship. This assessment covers areas such as strategy, systems, management control, marketing operations, financing incentives, intercompany obligations, centralized treasury functions and transfer pricing arrangements. In general, tighter operational and strategic integration increases the likelihood of support, although, similar to ownership, integration alone is not viewed as a significant driver of implicit support and needs to complement other Primary Considerations to justify the rating uplift.

The assessment of the factors considered for implicit support is largely subjective. The aforementioned list should not be considered exhaustive, and, depending on the credit and/or industry, other factors may be considered in addition to the Primary Considerations. Examples include the potential for regulation to influence the relationship between the two entities, the historical track record of the Supporting Entity toward the Supported Entity and the potential for complications when both entities are not domiciled in the same country. The assessment of factors underpinning implicit support may change and may lead to change in the Supported Entity's rating, relative to the Supporting Entity.

APPENDIX: Government Guarantees

DBRS recognizes that not all of the general expectations set out above for corporate guarantees may be met in the case of a government guarantee of a government related entity. Nevertheless, DBRS may allow for the rating of the Guarantor (i.e., the government) to flow through to that of the Guaranteed Entity (i.e., the GRE), provided DBRS is generally satisfied that the following characteristics are present:

- The supporting government (Guarantor) has clearly signaled its intent to honour the guarantee by providing a guarantee that is authorized by legislation, an order in council or some other executive order of government; and
- The Guaranteed Entity fulfills a public policy objective, or there is some other kind of evidence, satisfactory to DBRS, of an intent of the Guarantor to honour the guarantee, assessed on a case by case basis.

Where there is no government guarantee, *DBRS Criteria: The Link Between Sovereign Ratings and Government Related Entities* or *Rating Canadian Provincial Agents of the Crown* may apply.

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METHODOLOGY

Global Methodology for Government Related Entities

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Table of Contents

Scope and Limitations

This methodology provides an overall framework for determining the ratings of Government Related Entities (GREs) or debt issued by a GRE. It may be applied to a variety of entities owned or controlled by national, regional or municipal governments, provided that the entity's creditworthiness is very closely tied to the government's creditworthiness. This framework is complemented by several existing public sector methodologies, such as *Rating Public Universities*, which describe a sector-specific analytical approach and may allow for greater differentiation among the individual GREs within that sector as well as between the ratings of those entities and the rating of the controlling government. The methods described herein may not be applicable in all cases; the considerations outlined in DBRS methodologies are not exhaustive and the relative importance of any specific consideration can vary by issuer. This methodology is meant to provide general guidance regarding the DBRS methods and should not be interpreted with formulaic inflexibility, but understood in the context of the dynamic environment in which it is intended to be applied.

Overview

GREs include institutions, administrative bodies, agencies and public corporations formed or nationalized by a government to carry out specific public policy roles and functions. Examples include social security administrations, privatization agencies, electric utilities, export credit financing vehicles or guarantee issuance facilities. Some of these GREs engage in financing activities on behalf of the government, in pursuit of their specific mandate. The specific accountability arrangements between a government and a GRE may vary, but the conditions below are more likely to be met when the government exercises effective control of the entity. Companies that are partially owned by the government may be considered GREs.

This methodology is generally only used when the GRE's creditworthiness is directly and closely tied to the government's creditworthiness, such that the performance and overall financial condition of the entity itself does not have a material impact on the rating. This usually derives from the importance of the role performed by the GRE, and the existence of strong legal or reputational reasons for the sponsoring government to lend support to the GRE. In cases where a range of similar GREs exist within a country or region (e.g., public hospitals, universities, municipal utility companies, etc.), DBRS typically relies on a sector-specific methodology. This approach allows for better differentiation within a given sector and reflects the need to consider differences with regard to financial condition, essentiality and other key rating factors.

The basic institutional structure of a government may also have some bearing on whether ratings are determined under this methodology or by a separate sector-specific methodology. In general, the relationship between a central government's rating and its government related entities is likely to be weaker within a more decentralized political system (e.g., federations granting relatively more autonomy to sub-sovereign government units and government-related entities).[1] The applicability of domestic bankruptcy law and related provisions to GREs is also a key consideration.

1. This principle broadly reflects the approach discussed in *Rating European Sub-Sovereign Governments*, in which a greater weight is attached to the higher-tier government rating when the lower-tier government has less autonomy.

Applying Government Ratings to GREs

DBRS may apply the government rating to a GRE if the government has issued explicit guarantees which conform to the characteristics described in *DBRS Criteria: Guarantees and Other Forms of Explicit Support*.[2] Alternatively, DBRS may apply the government rating to a GRE if the following conditions are met:

1. The status of the GRE is clearly specified by legislation or regulation. (Note that in cases where the underlying legislation or regulation is unclear about the status of the entity being rated, an outside legal opinion may be sought by DBRS.)
2. There is a clear commitment from the government to honor GRE obligations, potentially taking the form of one or more of the following:
   i. Special legal status that effectively requires the government to honor GRE obligations;
   ii. A specific pledge of financial resources through capital replenishment, compensation for operating losses, or assumption of debt obligations in the event of dissolution or insolvency.
3. The GRE has been authorized by the government to borrow and conduct the activities covered by the credit rating being assigned, and there are no provisions in the constituting act or the terms of the debt precluding the applicability of the GRE's status to borrowing or the other activities potentially covered by the credit rating being assigned.
4. Available evidence indicates that the government has sufficient ability to support the GRE, such that even in the absence of a formal guarantee, any difference in the likelihood of default is not sufficient to result in a differentiation between the government ratings and the ratings of the GRE.

As a consequence of the conditions listed above, in more centralized political systems where sub-sovereigns lack the necessary legislative authority and derive most of their revenue from the central government, it may not be possible to apply a sub-sovereign's rating to a GRE in the absence of either explicit or implicit endorsement by the central government of the sub-sovereign's commitment to support the GRE.

Even if the above conditions are met, DBRS may in some cases apply a rating to the GRE that is below the government rating.[3] This would typically reflect DBRS' view that government commitments fall short of effectively guaranteeing equal ranking between direct government obligations and GRE obligations. It could also reflect a lack of broad-based political support for the GRE, suggesting that political developments could have an impact on commitments to support the GRE. A default by a government is typically a traumatic event and the precise ranking of government obligations may be unclear. In a stress scenario, DBRS analysis focuses on whether or not the government could be expected to attach the same importance to honoring the GRE's obligations as it does to honoring its own direct obligations.

In cases where government guarantees are not comprehensive and where the other conditions described above are not met, DBRS typically does not apply the government rating to the GRE. Instead, DBRS conducts a full credit assessment of the entity, which is based on an evaluation of the GRE's intrinsic credit fundamentals and factors in any prospects for support from the government. In addition, DBRS usually conducts a full credit assessment of GREs that benefit from material independent sources of revenue.

2. http://www.dbrs.com/research/305786/dbrs-criteria-guarantees-and-other-forms-of-support.pdf.
3. The scope of this notching below the sovereign, as applied under this criteria, is not expected to exceed two notches.

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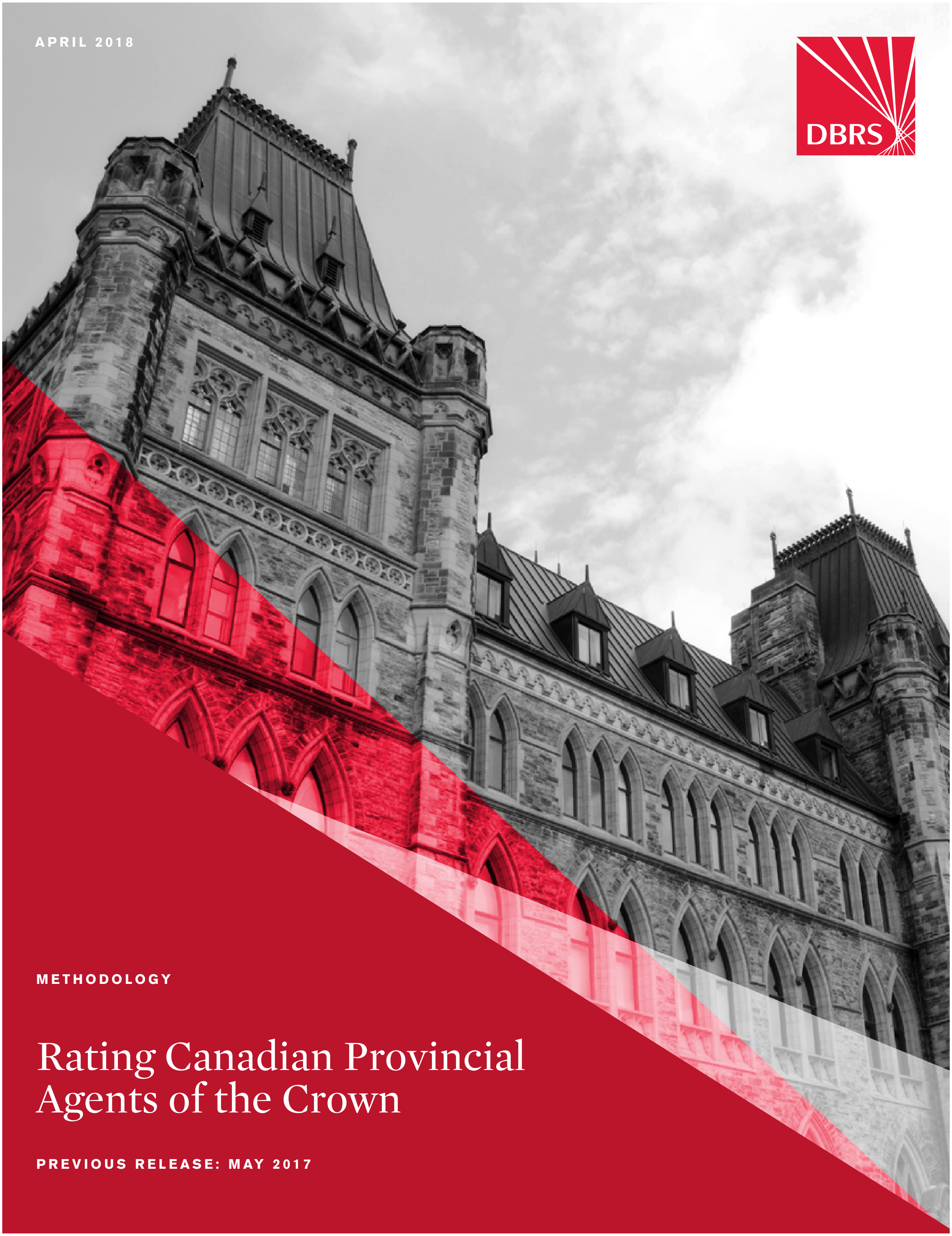

METHODOLOGY

Rating Canadian Provincial Agents of the Crown

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Table of Contents

Scope and Limitations

This methodology represents the current DBRS approach for ratings of Canadian provincial agents of the Crown. The methods described herein may not be applicable in all cases; the considerations outlined in DBRS's criteria are not exhaustive and the relative importance of any specific consideration can vary by issuer. Further, this methodology is meant to provide guidance regarding the DBRS methods used in the sector and should not be interpreted with formulaic inflexibility, but understood in the context of the dynamic environment in which it is intended to be applied.

Applying Provincial Ratings to Crown Agents

Crown agents include administrative bodies, agencies and public corporations formed by a government to carry out specific public policy roles and functions. Examples include utilities and municipal financing agencies. Some of these Crown agents engage in financing activities on behalf of the government, in pursuit of their specific mandate. For Canadian federal government crown agents, refer to DBRS's criteria, *The Link between Sovereign Ratings and Government Related Entities*.

The scope of this methodology is to explain how DBRS determines whether the rating of a province can be applied to a provincial Crown agent. Applying the provincial rating effectively implies that the Crown agent's creditworthiness is directly tied to the province's creditworthiness.

When rating the debt instruments of a Canadian provincial Crown corporation designated as an agent of a provincial government, DBRS will generally assign the rating of the parent government if all three of the following conditions are met:

1. The status of agent is explicitly provided to the organization through legislation or regulation. (Note that in cases where the act is unclear about the status of the entity being rated, an outside legal opinion may be sought by DBRS.)
2. The agent is empowered in its constituting act to borrow and conduct the other activities potentially covered by the credit rating being assigned.
3. There is no provision in the constituting act or the terms of the debt precluding the applicability of the agent status to borrowing or other activities potentially covered by the credit rating being assigned.

These conditions recognize that provincial governments are ultimately liable for the mandated actions of their agents.